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IN THE

Supreme Court of the United States

October Term, 1971.

No. 71-1425.

IN THE MATTER OF
PENN CENTRAL TRANSPORTATION COMPANY,
Debtor.

CENTRAL PENN NATIONAL BANK,
FIRST NATIONAL BANK OF MARYLAND,
FIRST WISCONSIN NATIONAL BANK OF MILWAUKEE, WISCONSIN,

and

NATIONAL BANK OF DETROIT,

v. *Petitioners,*

TRUSTEES OF THE PROPERTY OF THE PENN CENTRAL TRANSPORTATION COMPANY,
Respondent.

BRIEF FOR RESPONDENT IN OPPOSITION.

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QUESTIONS PRESENTED.

1. Did the courts below properly hold that the commercial banks in which the debtor-railroad in reorganization maintained working deposit accounts had no right to set off, subsequent to the filing of the petition for reorganization, the balance in those accounts against indebtedness of the debtor-railroad to those banks?

2. Do the assertions by commercial banks of set-offs arising subsequent to the filing of a petition for the reorganization of a railroad raise substantial adverse claims depriving a reorganization court of summary jurisdiction to prevent an interference with the reorganization process caused by the set-offs?

3. Does a reorganization court presiding over the reorganization of a railroad have the power in a summary proceeding to restrain the exercise by banks of set-offs which would result in the cessation of rail operations and frustrate reorganization?

STATEMENT OF THE CASE.

On June 21, 1970 the Penn Central Transportation Company ("Debtor") filed a petition seeking reorganization under Section 77 of the Bankruptcy Act, 11 U.S.C. § 205, in the United States District Court for the Eastern District of Pennsylvania, alleging that it was unable to meet its debts as they mature.

At that time, the Debtor maintained deposit balances in 142 commercial banks, those accounts being utilized to meet current operating expenses of the railroad. Those same banks were also creditors of the Debtor, holding either matured obligations or, as in the case of petitioners, holding unmatured obligations which, under the loan agreements and other instruments of indebtedness, became due and payable in the event a petition for reorganization was filed.

On the date the petition was filed, the court entered, *ex parte,* Order No. 1 approving the petition and providing in Paragraph 10:

> "10. All persons, firms and corporations . . . holding for the account of the Debtor deposit balances or credits . . . are restrained and enjoined from . . . offsetting the same . . . against any obligation of the Debtor, until further order of this Court."

Moreover, in amended Paragraph 7 of Order No. 1 entered on June 23, 1970,[1] the court authorized all depositories of Debtor's funds to honor all checks, drafts and vouchers, without prejudice to any claim of set-off or priority.

All but nine of the 142 banks complied with the terms of Order No. 1. Those nine banks, four of whom are peti-

1. The Court of Appeals decision (A2) incorrectly recites the date of amendment as June 23, 1971.

tioners, despite notice having been given them of the entry and terms of Order No. 1, subsequently made the necessary bookkeeping entries to effectuate the set-offs and, accordingly, refused to honor the Debtor's checks drawn upon those accounts. The Debtor's deposit balances in those banks aggregated approximately $4,500,000.

There has been no challenge to the Reorganization Court's conclusion that if all of the Debtor's 142 depositories "had attempted the same disregard of the express terms of the Order [No. 1], the operation of railroad service by the debtor would have been impossible." (A19).[2]

On July 14, 1970, pursuant to the Debtor's petition, the Reorganization Court issued an order to show cause why the banks should not be adjudged in contempt for violations of Order No. 1; and "why each of them should not be required forthwith to honor Debtor's withdrawals to the full extent of all moneys now on deposit with such banks." At the hearing on the order to show cause before the Reorganization Court, at which the banks appeared specially through counsel, the banks contended that Order No. 1 was invalid, having been entered *ex parte*, and that the Reorganization Court was without jurisdiction to adjudicate in a summary proceeding a purported right of set off.

Testimony offered by the Debtor during the hearing revealed that $12 million in payrolls were payable on June 23, 1970, and an additional $13 million on June 25 and 26, 1970; that the Debtor would not have been able to meet those payrolls had a substantial number of the depository banks set off as did petitioners; and that the Debtor was in dire need of cash, evidenced by the fact that there was a $45 million projected excess of disbursements over receipts during the months of July and August, 1970.

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2. Hereinafter page references to the Appendix to the petition will be designated by the letter "A", and to the petition itself by the letter "P".

Subsequently, the Reorganization Court, after hearing the testimony and the arguments of counsel, entered Order No. 24 which required the banks to restore the balances to the Debtor's accounts and to honor checks and withdrawals to the full extent of funds on deposit. The adjudication of contempt was held in abeyance. The Reorganization Court held, first, that assertions of purported rights of set-off, arising by reason of the mere act of filing a petition for reorganization do not raise real and substantial adverse claims,[3] and second, that set-offs which would have deprived the Debtor of its cash deposits necessary for the continuation of railroad operations were contrary to the objectives of Section 77. Hence, the Reorganization Court ruled that enjoining the exercise of set-offs was within the powers it possessed as a court of equity. The Reorganization Court further held that the *ex parte* entry of Order No. 1 was a valid and necessary exercise of the court's power, enabling the Debtor to continue railroad operations.

Seven of the nine banks appealed from the entry of Order No. 24 to the United States Court of Appeals for the Third Circuit. Prior to argument before the Court of Appeals, the Debtor caused all funds then on deposit with the seven appealing banks to be withdrawn, and there presently exist no deposit balances with petitioners. Despite the Debtor's argument that the withdrawal of all funds rendered moot the issues raised on appeal, the Court of Appeals heard argument on the merits of the appeal.

On December 23, 1971, the Court of Appeals issued, without dissent, its decision affirming the judgment of the Reorganization Court. The Court of Appeals held that a Reorganization Court has the power in a summary pro-

3. One of the nine banks, the National City Bank of Cleveland, had accomplished its set-off prior to the filing of the petition. The Reorganization Court ruled that the assertion of that set-off raised a real and substantial adverse claim. The decision as to the National City Bank of Cleveland has not been appealed from.

ceeding to prevent the exercise by banks of "self help through the remedial device of set-off", when the exercise would unduly interfere with the reorganization process and would defeat the jurisdiction of the Reorganization Court.

Of the 142 banks originally subject to the Order, four banks, petitioners herein, have filed a petition for a writ of certiorari urging this Court to review the unanimous decisions of the courts below.

REASONS FOR DENYING THE WRIT.

I. Introduction.

A. The Decisions Below.

Because petitioners have adopted somewhat varying arguments in the different stages of this litigation, it is necessary to summarize the rationale of the case as decided by the Reorganization Court and the Court of Appeals.[4]

The bank accounts concerned here constituted property of the Debtor at the time of reorganization (A3, A18). Accordingly, the Reorganization Court had exclusive jurisdiction over such property (A3, A18).

The Reorganization Court's exclusive jurisdiction over the Debtor's property may be exercised by *summary*, as distinguished from *plenary* process, in the absence of a substantial adverse claim to such property (A5-6, A18). The claimed right of set-off is not an adverse claim ousting the Reorganization Court of summary jurisdiction. Rather, it is a remedial device, a creditor's recourse to self-help, which can be suspended to insure continuity of rail operations during the course of the reorganization (A6, A16-17). Because the right of self-help in this case would have frustrated the reorganization by shutting down the railroad, its exercise could be properly enjoined (A6, A18-19).

Since the public interest required a suspension of the right of self-help at the beginning of the reorganization, the banks should be permitted a subsequent opportunity to seek equitable relief by virtue of such suspension (A6, A14).

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4. Petitioners have abandoned their attack on the validity of *ex parte* Order No. 1 approving the Debtor's petition for reorganization. The analysis of that aspect of the case is therefore omitted.

B. Petitioners' Claim.

Petitioners have never disputed that the Debtor's rights to withdraw its deposits constitute " 'property' of the debtor within the meaning of Section 77(a) of the Bankruptcy Act. . . ." (P13). Accordingly, by petitioners' own admission, their arguments before the Reorganization Court conceded that that court "had threshold summary jurisdiction to determine whether the petitioners' set-offs constituted real and substantial adverse claims to the debtor's deposit balances." (P10).

In the instant petition, petitioners' contention has somewhat altered. While admitting that the litigation involves "property" of the Debtor, petitioners would limit the scope of the Reorganization Court's summary jurisdiction to a determination of the debtor's ownership rights, a matter not in dispute here (A13-14). The contention that a reorganization court may determine ownership over property within its jurisdiction under Section 77(a) of the Bankruptcy Act but can do nothing further is a novel, last-ditch, effort to blunt the clear thrust of reorganization precedents.

For the reasons detailed below, the rationale of the case as decided by the courts below is soundly based in law and fact.

II. The Assertion of Set-off Under the Circumstances of This Case Does Not Raise a Substantial Adverse Claim Depriving the Reorganization Court of Summary Jurisdiction.

A. The Choses in Action Represented by the Bank Accounts Came Into the Constructive Possession of the Reorganization Court.

Section 77(a) of the Bankruptcy Act, 11 U.S.C. § 205(a) grants to a reorganization court exclusive juris-

diction over a debtor and its property wherever located and vests the court with "all the powers . . . which a court of the United States would have had if it had appointed a receiver in equity of property of the debtor. . . ." The Court of Appeals, relying upon this grant of jurisdiction and authority, held that the Reorganization Court "may exercise the power of an equity court admistering a receivership to restrain creditors . . . from setting off the debtor's choses in action, to satisfy outstanding obligations."

This Court has itself given recognition to this jurisdiction of a district court presiding over the reorganization of a railroad. In *Gardner v. State of New Jersey,* 329 U.S. 565, 577 (1947), Justice Douglas stated:

> "[Exclusive] jurisdiction is not limited to the prevention of interference with the use of the property by the trustee; it extends also to the adjudication of questions respecting the title. Ex parte Baldwin, 291 U.S. 610, 616, 54 S. Ct. 551, 554, 78 L. Ed. 1020; Thompson v. Texas Mexican Ry. Co., 328 U.S. 134, 140, 66 S. Ct. 937, 942. *It is the exclusive jurisdiction of the reorganization court which gives it power to preserve the railway as a unit and as a going concern* and to prevent it from being divided up and dismembered piece-meal. *Only in that way can continuous operation of the road be assured and a plan of reorganization be effected* which not only safeguards the interests of the various claimants but is also compatible with the public interest." [Emphasis added]

See also, *Ecker v. Western Pacific R. Corp.*, 318 U.S. 448, 466-475 (1943), and *Smith v. Hoboken Railroad, Warehouse & Steamship Connecting Co.,* 328 U.S. 123, 133 (1946).

The property of the Debtor in these proceedings subject to the exclusive jurisdiction of the Reorganization Court is the choses in action represented by the bank accounts, or the right of the Debtor to withdraw funds from those accounts. As shown before, petitioners concede that when the petition for reorganization was filed the Debtor's right to withdraw the funds was not disputed. Thus, the choses in action, as to which no adverse claim could have been made, came within the constructive possession of the court. See *In re Weston*, 68 F.2d 913 (2d Cir. 1934); and *In re Wiltze Bros. Corp.*, 357 F.2d 190, 193 (6th Cir. 1966), in which it is said:

> "Where a debt is owed the bankrupt, such intangible may be in the constructive possession of the Bankruptcy Court if the bankrupt remained the legal owner up to the time of filing the petition. 2 Collier on Bankruptcy, § 23.05, p. 487. The bankrupt may have such possession of intangible property as to give the Bankruptcy Court summary jurisdiction to determine which claimant is the proper obligee of a chose in action."

The petitioners assert that the exercise of a purported right of set-off subsequent in time to the entry of Order No. 1 extinguished the chose in action and transferred ownership to themselves. The Court of Appeals held that the Reorganization Court could properly enjoin the exercise during reorganization of that self-help remedy, preserving the exclusive jurisdiction of the court over the chose. The Court of Appeals stated:

> "Here, the dispute is not about the existence or amount of any bank's indebtedness to the railroad on June 21, 1970 when reorganization proceedings were instituted, but rather whether the banks are privileged during the

> pendency of reorganization, to elect to satisfy their own claims against the railroad by self help through the remedial device of set-off. ***The reorganization court has merely denied them resort to that remedy during reorganization."

In a concurring opinion, Chief Judge Seitz gave an additional reason:

> "It is for the reorganization court, however, to decide at the outset whether adverse claims in fact exist. *See* May v. Henderson, 268 U.S. 111, 115 (1925). The sole basis for the claims here asserted is the contractual right of set-off embodied in the various loan agreements existing between Penn Central and the appellants. The reorganization court determined, as it is permitted to do, that in the factual setting of this reorganization the right should not be recognized."

B. Set-off in Reorganization Proceedings Is Not an Absolute Unqualified Privilege.

Section 68 of the Bankruptcy Act, 11 U.S.C. § 108, which makes provision for set-offs in bankruptcy proceedings is not to be applied automatically and absolutely in reorganization proceedings. This Court in *Lowden v. Northwestern Nat. Bank & Trust Co.*, 298 U.S. 160, 164 (1936), a railroad reorganization proceeding under Section 77, held that:

> ". . . section 68 of the statute does not control the disposition of the controversy ex proprio vigore. It governs, if at all, by indirection and analogy according to the circumstances."

On remand from this Court's decision in *Lowden*, the Eighth Circuit Court of Appeals ruled that the bank claim-

ing a set-off had failed to sustain its burden of establishing a right to set off. *Lowden v. Northwestern Nat. Bank & Trust Co.*, 84 F.2d 847, 855 (8th Cir. 1936). In that case the court of appeals said that the mere filing of a petition for reorganization:

> ". . . gave to the bank no right of set-off, and that, for that purpose, it could not regard the petition, under the circumstances, as the equivalent of a voluntary petition in bankruptcy. For the purpose of set-off, it would not be consistent with the provisions of section 77 to treat a debtor in reorganization proceedings as a voluntary bankrupt unless it appeared that insolvency actually existed and that liquidation and distribution of assets, rather than reorganization and rehabilitation, was in order."

Since the date of the *Lowden* decisions of this Court and the Eighth Circuit Court of Appeals, the courts which have faced this issue have uniformly and consistently held that the application of set-offs in a reorganization context is inconsistent with the ends reorganization seeks and should not be allowed. *Tyler v. Marine Midland Trust Co. of New York*, 128 F.2d 927 (2d Cir. 1942); *Chase National Bank v. Lyford*, 147 F.2d 273 (2d Cir. 1945); *Susquehanna Chemical Corp. v. Producers Bank & Trust Co.*, 174 F.2d 783 (3d Cir. 1949); *In re Yale Express Systems, Inc.*, 362 F.2d 111 (2d Cir 1966); and *In re Central Railway Co. of New Jersey*, 273 F. Supp. 282 (D.N.J. 1967), aff'd *per curiam* 392 F.2d 589 (3d Cir. 1968).

In the *Lowden* opinion, this Court was careful to point out the vital difference between reorganization and bankruptcy. Justice Cardozo stated (298 U.S. at 163, 164):

> "A proceeding to reorganize is not a bankruptcy, though an amendment to the bankruptcy act creates

> and regulates the remedy. From the fact without more than such a proceeding has been initiated, one cannot know that it will be necessary to have recourse to section 68, 11 U.S.C.A. § 108, which was meant in its enactment to prescribe the rule of set-off upon the distribution of assets. That stage of administration, or the analogous stage of a revision of the debts, may never be attained in a proceeding to reorganize, though a petition has been approved and trustees have been appointed."

This distinction between reorganization and bankruptcy has been the decisive factor in all of the cases following *Lowden* which have denied the right of set-off during reorganization. The reasoning of the Court of Appeals in *Susquehanna Chemical Corp.* is illustrative (174 F.2d at 786, 787, 788):

> "In bankruptcy the object is to liquidate the assets of the bankrupt, to pay off his creditors as quickly and inexpensively as possible and to free the bankrupt from the burden of accumulated debt so that he may begin his business life anew. But the purpose of reorganization is not liquidation at all. If reorganization is successful the debtor corporation will continue to function, to pay its creditors and carry on its business. The purpose of reorganization is to save a sick business, not to bury it and divide up its belongings. It is evident that the application of the unqualified right of set-off might be enough, without more, to defeat the purpose of reorganization.
>
> * * *
>
> What [the] creditor bank did, at the beginning of reorganization, was the thing most calculated to throw

a monkey wrench into the whole machinery of reorganization. The bank seized its cash."

Petitioners, on the other hand, cite to this Court a series of set-off cases in straight bankruptcy proceedings, where the right is clearly established and unqualified. Moreover, none of the reorganization cases[5] cited by petitioners involved any issue of set-off. The reason in fact may be that petitioners' research also revealed no reorganization case which has permitted set-offs pending reorganization.

C. The Claimed Right of Set Off Arising Solely by Reason of, and Only After, the Filing of a Petition for Reorganization Does Not Raise a Real and Substantial Adverse Claim.

Petitioners have attempted to negate the importance of the timing of the assertion of the set-offs in relation to the filing of a petition for reorganization. The say there can be no distinction between pre-petition and post-petition set-offs. In support they point, on pages 18 and 19 of their petition, to the fact that the Court of Appeals did not disturb the Reorganization Court's ruling that the *pre-petition* set-off by the National City Bank of Cleveland raised a substantial adverse claim. They fail to mention, however, that neither the Debtor nor the National City Bank appealed from that ruling and, hence, there was absolutely no occasion for the Court of Appeals even to consider it. Petitioners also make a vague reference to the "negative

5. The reorganization cases cited by petitioners in support of their position are *Meyer v. Fleming*, 327 U.S. 161 (1946); *First National Bank in Houston v. Lake*, 199 F.2d 524 (4th Cir. 1952); *In re Italian Cook Oil Corporation*, 91 F. Supp. 72 (D. N. J. 1950); *In re Standard Gas & Electric Co.*, 119 F.2d 658 (3d Cir. 1941); *Thompson v. Terminal Shares*, 104 F.2d 1 (8th Cir. 1939); *Bovay v. H. M. Byllesby & Co.*, 88 F.2d 990 (5th Cir. 1937).

import" of *Lowden* and to what this Court "would have" done in *Lowden*, had the question been presented.

The case of *In re Chicago & N.W. Ry. Co.*, 86 F.2d 508 (7th Cir. 1936), is the only reorganization proceeding relied upon by petitioners in which the issue of set-off was involved. In that case, however, the set-off had been accomplished prior to the filing of the petition for reorganization, compelling the court of appeals to rule that a substantial adverse claim arising prior to reorganization deprived the court of summary jurisdiction. In effect, the court held that since the debtor railroad was not the *undisputed* legal owner of the chose in action when the petition for reorganization was filed, the chose did not come within the constructive possession of the court. That holding is consistent with the rule that any intangible, such as a chose in action, is in the constructive possession of a bankruptcy court only if the bankrupt or debtor "remained the legal owner up to the time of filing the petition." *In re Wiltze Bros. Corp., supra.* The Court of Appeals in *Chase Nat. Bank of City of New York v. Lyford*, 147 F.2d at 277, distinguished the *Chicago & N.W. Ry Co.* case on this ground and characterized it as being "significantly different on its facts." The facts in *Lyford* are practically identical to those here. Like this reorganization proceeding, the proceeding in *Lyford* began with the entry of an *ex parte* order restraining set-offs. While the bank in *Lyford* was presumed to have consented to the summary jurisdiction of the reorganization court, the court of appeals cited an additional, independent reason sustaining jurisdiction. It said:

> "In addition, we have the fact that, since the bank knew of the injunction order when it applied the balance, it acted in violation of that order. Accordingly, the court could, in a summary proceeding, direct the

bank to restore the status quo, with the result that the bank's claim stood just as it would have if the bank had not taken that action. . . ."

Pre-petition set-offs, unlike the post-petition set-offs claimed in this case, are asserted for reasons other than the mere filing of a petition for reorganization, which according to at least one commentator is no reason at all. FINLETTER, BANKRUPTCY REORGANIZATION, 306-307 (1939). There it is stated:

> "The case of a bank which has a deposit account of the debtor in its banking department and owns unmatured debentures of the debtor in another department illustrates the point. There is no expectation between the parties as a business matter that these debts may be set off, and there is no reason in equity why they should be, unless the pendency of the reorganization proceeding itself supplies this equity. It is not believed that it does so, but that on the contrary a right of set-off under such circumstances is inconsistent with the end which the Act seeks."

The burden of justifying the asserted right of set-off was upon the petitioners. *Lowden v. Northwestern Nat. Bank & Trust Co.*, 84 F.2d 847 (8th Cir. 1936). Not only did petitioners fail in sustaining that burden, but the fatal consequences to the debtor and to the prospects of reorganization wrought by set-offs against deposit accounts in reorganization proceedings generally, and in this railroad reorganization particularly, compel the results reached by the Courts below.

Petitioners made no other claim with respect to the Debtor's deposit balances other than the asserted right of set-off. The averment that the National Bank of Detroit,

a petitioner herein, and the Debtor entered into a compensating balance arrangement is a sham and the Reorganization Court and the Court of Appeals properly ignored it as lacking any substance. The only evidence on the record wholly negates petitioners' averment.[6] Moreover, this matter was not raised or urged before the Court of Appeals either in briefs or oral argument by petitioners.

D. A District Court Presiding Over the Reorganization of a Railroad Has the Power in a Summary Proceeding to Restrain the Exercise of Set-offs Which Would Result in the Cessation of Rail Operations and Frustrate Reorganization.

The petitioners, rapt in their own self-interest, refuse to recognize and to deal with the findings by the Reorganization Court, cited by the Court of Appeals, that set-offs by a substantial number of the Debtor's depository banks would have deprived the Debtor of its working cash needed

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6. The testimony of John H. Shaffer, Treasurer of the Debtor on this point is as follows:

> Q. Mr. Shaffer, one further question: Was not the account with National Bank of Detroit in effect a compensating balance account?
>
> A. No, our account of the National Bank of Detroit was a very active account. It handled all of our receipts for that whole area up in the Michigan area. I would say that this was one of the—from an activity standpoint one of our most active banks. So the bulk of our balances there would be covering activity as well as a considerable amount of float in the account.
>
> Q. Mr. Shaffer, I show you a letter dated April 30, 1970. Does that letter not indicate that the account is to be a compensating account, compensating balance account?
>
> A. Again it includes the words "compensatory level," but in normal business dealings between corporate treasurers and banks, all balances hinge upon our level of cash. Sometimes we have a high balance, sometimes a low balance, and normally we do try to keep balances in order to cover all of our activity.

to meet payrolls and other current operating expenses required for continued operation of the railroad. And while they acknowledge the vital public interest in the maintenance of normal rail operations during reorganization, petitioners contend that claims of set-off, which indisputably frustrate that public interest, and which arise solely by reason of the reorganization itself, are beyond the power of a reorganization court to deal with under Section 77. Thus, petitioners say, Congress left to the mercy of commercial banks the success or failure of all railroad reorganizations.

The Court of Appeals rejected petitioners' argument, holding that Section 77 vests a reorganization court with jurisdiction to restrain in a summary proceeding the exercise of the remedy of set-off, which, under the facts found to exist by the Reorganization Court, would have defeated the process of reorganization.

The Court of Appeals relied, in part, on *Continental Illinois National Bank & Trust Co. v. Chicago, R. I. & P. Ry. Co.*, 294 U.S. 648 (1935), in which this Court held that a district court presiding over the reorganization of a railroad has summary jurisdiction to prevent the sale of collateral, which was in the possession of commercial banks to secure indebtedness of the railroad to the banks. In that case the district court found, after a hearing, that the instruments of indebtedness provided for default in the event of insolvency or appointment of a receiver; that upon default the collateral security could be sold; that there was a danger that the banks would sell the collateral; and that such a sale would hinder, obstruct and prevent the orderly consummation of a plan of reorganization, and, therefore, was contrary to the purpose of Section 77. This Court held that by virtue of its powers as a court of equity, and by reason of the provisions of Section 2(15) of the Bank-

ruptcy Act, 11 U.S.C. § 11 (15),[7] a reorganization court could prevent the sale of collateral to achieve the objectives of Section 77. That this power could be exercised in a summary proceeding is clear from the following excerpt from this Court's opinion (294 U.S. at 681):

> "Obviously, an application for an injunction against the immediate enforcement of a remedy is not the assertion of an adverse claim. The bonds deposited as collateral were not in the hands of purchasers, but in the hands of creditors as creditors as security. That the equity which the debtor retained was a property interest was not and could not be disputed by the creditors. . . . In short, no adverse claim was brought forward by either of the parties to the controversy. The only question was in respect of the creditors' remedy; and the sole point is as to the authority of the bankruptcy court to delay for a reasonable time an interference with the reorganization proceeding which would result from an immediate sale of the collateral."

If petitioners are correct in their contention that Order No. 24 was an invalid exercise of the Reorganizantion Court's power, the Debtor would not have been able to continue rail operations for it would have been deprived of the millions of dollars essential for those operations. That condition would have continued until it, or the Trustees, had sought and obtained the necessary relief from courts of general jurisdiction in each of the forums in which the Debtor's 142 depository banks were located. That pro-

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7. Section 2(15) of the Bankruptcy Act invests in courts of bankruptcy power to:

> "Make such orders, issue such process, and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this Act. . . ."

cedure would involve delay sufficient to frustrate and destroy the efforts to reorganize. It would result in a multiplicity of suits with the risk of varying, and possibly contrary, adjudications with respect to matters more appriate for determination by the Reorganization Court. As the Court of Appeals said:

> "It was neither necessary nor desirable to have that matter adjudicated in a court of general jurisdiction, for the dispute was within the area of special concern and competency of the reorganization court and it did not present any controversy about entitlement to property when reorganization began."

That the equitable powers of a reorganization court are broad enough to preserve the court's jurisdiction and to prevent an interference with reorganization whenever the dictates of a case require it is clear from the opinion in *Gardner v. State of New Jersey*, 329 U.S. at 577, 578. In *Gardner* this Court has given effect to the "practical requirements" of each case in interpreting the scope of a reorganization court's power. There it is stated:

> "When § 77 is read against this historical background and in light of practical requirements, we cannot conceive that Congress gave the reorganization court power less replete than the sweeping language of § 77 suggests."

The Reorganization Court likewise recognized the practical necessity of restraining set-offs during the initial stage of railroad reorganizations. The court said:

> ". . . it is inconceivable that Congress intended that a railroad under section 77 reorganization should be deprived of the use of its cash, by the very act of filing the reorganization petition."

It is clear that Order No. 24 was the product of a valid and necessary exercise of authority by the Reorganization Court.

E. The Interests of Petitioners Were Adequately Protected by the Reorganization Court.

By amendment to Paragraph 7 of Order No. 1 the Reorganization Court provided (Order No. 4):

> ". . . the honor pursuant to this Order by any depository of checks, drafts or vouchers drawn by the Penn Central Transportation Company prior to the filing of the petition herein or drawn by the Debtor in possession thereafter shall be without prejudice to any claim of set-off and/or any claim of priority by such depository."

The Debtor has maintained normal banking relations with all of its depository banks, with the exception of petitioners. These relations include the deposit of funds as well as their withdrawal. Should these banks, or petitioners, decide that the course of the reorganization dictates preferential or other equitable relief by virtue of the denial, at the outset of the reorganization, of the right of set-off, the claim has not been prejudiced. Thus a fair balance has been struck between the public interest in continued rail service and the protection of legitimate creditors' rights. As a result, there is really no need for further judicial review at this time. See *Lowden v. Northwestern Nat'l Bank & Trust Co.*, 298 U.S. at 163, 164.

III. The Proceedings Below Lacked No Essential of Due Process.

The petitioners' contention that the proceedings before the Reorganization Court lacked due process is not directed

at Order No. 1, which was entered *ex parte*. Petitioners took no appeal from Order No. 1 and chose to disobey it. In any event, petitioners have not attacked the validity of that order in their petition.

The Court of Appeals accurately described the propriety of the procedures employed in the Reorganization Court:

> "It is true that, *ex necessitate rei*, the original order approving the present reorganization petition and restraining set-off until further order of the court was entered ex parte. But the order from which this appeal has been taken . . . was entered only after notice, a full hearing and judicial consideration of all testimony and argument that these appellants chose to present."

Petitioners' citation of *Smith v. Belford*, 106 Fed. 658 (6th Cir. 1901), is inapposite. *Smith v. Belford* was a straight bankruptcy case, in which the bankrupt, prior to the petition for bankruptcy being filed, assigned all right, title and interest in his property to a third person. The entry of an *ex parte* order affecting that property in which the bankrupt had no interest was clearly beyond the power of the court. In this case it is not disputed that when the petition for reorganization under Section 77 was filed, the Debtor was the legal owner of choses in action as to the funds on deposit with petitioners.

As the Court of Appeals pointed out, the order from which the appeal was taken, was entered only after notice, a hearing and after petitioners offered all the evidence they chose to present. The power of a reorganization court to act in this fashion is well established. It is also clear that summary proceedings before a court sitting pursuant to the provisions of the Bankruptcy Act do not offend tradi-

tional notions of fair play and do not deprive a party of due process. *Continental Illinois Nat'l Bank & Trust Co. v. Chicago, R. I. & P. Ry. Co., supra.*

The petitioners' claim, as the Court of Appeals noted, is really not:

> ". . . that the proceeding lacked due process or plenary character but rather that the reorganization court undertook to interfere with their claimed right of set-off rather than leaving this disputed question to adjudication in an original suit in some court of general jurisdiction."

The question is a jurisdictional one, not constitutional.

Further, despite petitioners' obvious dissatisfaction with the *outcome* of the decision by the Reorganization Court, they can itemize no failure of *process.* Even though the Reorganization Court, responding to an undisputed emergency affecting the public interest, ordered the deposits paid, it preserved for subsequent determination "any claim the banks might have to priority, by reason of any alleged right of set-off which would otherwise have existed, or otherwise." (A14).

As the Court of Appeals noted, petitioners have the right to bring before the Reorganization Court "the question of what preferential treatment, if any, should be accorded . . . [petitioners] at a later stage of the reorganization with reference to their claims which they have been prohibited from satisfying by set-off during the initial stage of reorganization." (A6).

IV. The Decision of the Court Below Is Consistent With Decisions of This Court and the Courts of Appeals.

The purported conflict between the decision of the Court of Appeals in this case and decisions of other courts

of appeals and of this Court does not exist. The cases involving straight bankruptcy proceedings cannot be logically contrasted with reorganization cases, since totally different statutory purposes are involved. Moreover, the reorganization cases relied upon by petitioners do not deal with the question of set-off. On the contrary, *Bovay v. H. M. Byllesby & Co., supra; In re Italian Cook Oil Corporation, supra;* and *In re Standard Gas & Electric Co., supra,* involved the validity of extraterritorial service of process under the Bankruptcy Act where the basis for jurisdiction was diversity of citizenship in a plenary suit instituted by trustees in the reorganization court.

The decision of the Court of Appeals is not only consistent with, but is dictated by, the prior decisions of this Court in *Lowden, Continental Illinois Nat'l Bank & Trust Co.* and *Gardner* v. *State of New Jersey.* In addition, the opinion is consistent with every other court of appeals decision in which the validity of set-offs during reorganization was in issue. There is nothing in *May v. Henderson,* 268 U.S. 11 (1925); *Harrison v. Chamberlin,* 271 U.S. 191 (1926); or *Meyer v. Fleming,* 327 U.S. 161 (1946) which compels a different result in this case.

CONCLUSION.

For the foregoing reasons, the Petition for a writ of certiorari should be denied.

Respectfully submitted,

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